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INDEBTEDNESS DURING THE MILITARY GOVERNMENT:
A STUDY OF THE 1960S AND 1970S IN BRAZIL

BY

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THESIS

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ABSTRACT

Between 1951 until the mid-1970s Brazil went through a phase of intense economic growth and development of its industry. This study aims to study the period in which the military took power and became responsible for implementing these goals of economic development – which include the years between 1964 until 1983 – looking for the kind of resources that were used in order to achieve economic growth. This study argues that the kind of economic growth chosen by the military, which relied strongly on foreign loans from the Eurocurrency markets, reproduced a model of economic development that proved to be unsustainable. The fact that these funds were able to move freely with the incentive laws created by the military left the Brazilian internal market access to credit subject to changes in the international scenario.

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INTRODUCTION

Brazil went through a phase of intense industrial development and growth throughout the 1950s until the mid-1970s. Throughout these decades government planning – specifically through the Ministry of Finance and Ministry of Planning – in conjunction with investments from the public and private sector were able to build a relatively developed industrial sector, which diversified the Brazilian economy. According to Jeffry Frieden, despite having major gaps in its economic and political system, in the 1960s Brazil had one of the broadest economies among the developing countries¹, which made the country less dependent on imports and also diversified its exports. It is extremely important to study this period in order to understand Brazilian authorities' decisions regarding the funding model chosen for the industry during the second half of the twentieth century, and the reasons and the consequences of these decisions. This funding model, which was based on foreign loans and foreign direct investment, lasted from around 1956 until the end of the 1970s, which represented the moment of its exhaustion. Even though the model was already highly dependent on foreign resources since 1956, after the 1964 military coup the authorities intensified the opening of the Brazilian market to foreign investment and borrowing.

The first great expansion of what became known as the Eurocurrency markets occurred in the mid-1960s. During the 1960s there was an oversupply of the goods produced by United States, Japan and Germany, which led to a decline of the profit rates in the productive sector in these countries. The consequence of this movement was that these profits would have to go through a process of recycling. Because space for investment in the productive sector was

¹ Jeffry Frieden, "The Brazilian Borrowing Experience: From Miracle to Debacle and Back", *Latin American Research Review*. Vol. 22 (1987): 97.

restricted, the profits from this sector started to be invested in the financial sector – in the currency market that existed outside the borders of the US, but operated in US dollars. This marked the first expansion of the Eurocurrency markets, which happened before the 1970s oil crisis².

Eager to tap into this great liquidity of the international markets for its own development projects, the Brazilian military regime created a set of laws that would encourage the private companies to borrow and motivate the international banks to provide the loans to the companies established in the country. The Brazilian gross external debt increased from \$ 3.2 billion in 1964 to \$ 17.1 billion in 1974. In 1978 it reached the figure of \$ 43.5 billion. As Jeffry Frieden explains, foreign borrowing became crucial to the Brazilian economic and political development after 1967, when “virtually every major portion of the modern economy came to rely on foreign finance, as borrowed dollars funded everything from steel mills to soccer teams”³. The governmental rhetoric was that those funds were necessary to modernize the economy.

When an international crisis emerged during the mid-1970s, private firms in the country decided to start a process of debt relief, and they decreased the pace of indebtedness with the international banks, gradually stopping to resort to this type of loan. The Brazilian government, however, decided that the country needed the foreign resources, and in order to maintain foreign borrowing, they created a set of measures to encourage the private companies to resort to the sources from abroad and increased the public companies’ borrowing. The problem, however, was that the private firms did not act as the government was expecting, and the public sector gradually had to increase its participation in the debt. The consequence of these measures was the rising indebtedness within the public sector, a process that became known as the

² François Chesnais, “A Globalização e o curso do capitalismo de fim-de-século”. *Economia e Sociedade* n.5 (1995): 19.

³ Frieden, “The Brazilian Borrowing Experience”, 95.

“nationalization of the debt”. In order to attract the external resources, the government took over the debt liabilities.

The 1964 government plan to favor the private firms with the laws that it created brought development to the Brazilian industrial sector; yet, it did it at extreme costs. For a small period of time, the Brazilian industrial sector had all the resources available for its development and growth. However, when the international crisis became evident, the private sector started a process of debt relief, and the Brazilian government forced the public into borrowing. In addition to this, the US Federal Reserve Bank promoted an internal monetary policy that increased drastically US interest rates, which led to the increase of the world’s interest rates, and, consequently, to the increase of the Eurocurrency market interest rates. Because borrowing from the international banks was made at floating interest rates, the Brazilian external debt increased at catastrophic rates. At this moment, the state would find itself in a drastic international crisis, at the same time that other peripheral nations were declaring moratorium on the debt, and foreign credit was not available any longer.

The Brazilian state entered the 1980s drowned in a foreign debt that had reached such numbers that the country would not be able to pay its services any longer – especially because at the time the foreign sources stopped offering credit, preventing the continuation of the debt rollover – unless the debt was renegotiated. The creditors came together and, under the intermediation and management of the International Monetary Fund, were able to renegotiate the debt with Brazil. Thus, the country was able to gradually pay the debt service, but at costs that deepened an economic crisis that would last for more than a decade. The country would only be able to completely recover from this crisis a quarter century later.

One of the contributions of this work is that it complements the literature that discusses the foreign indebtedness during the military regime in Brazil. In comparison to *Dívida Externa e Política Econômica* by Davidoff Cruz, this work gives a step forward by providing different data from *Banco Central do Brasil* bulletins and reports, and examining studies that were not available at the time for Cruz⁴, such as Monica Baer's. In addition, considering that Cruz focuses on the analysis of the internal monetary policies during the 1970s, this work deepens the investigation of the international scenario conditions, which is briefly acknowledged in Cruz's discussion, focusing on the explanation of the emergence of the Euromarkets and the changes in the international environment throughout the 1970s, and also on the austerity plans imposed by the IMF to indebted nations during the 1980s. By studying Cruz's work under the light of scholarship developed in later years and the data collected from *Banco Central do Brasil*, this paper will assert that the opening of the Brazilian market to international funds from the Euromarkets stimulated the development of a model of economic growth that proved to be unsustainable.

Between 1968 and 1973 it seemed that the foreign debt was generating economic growth, yet the following years showed that the debt-led growth – and the constant effort of the government in pushing for more indebtedness even though the private firms were not leaning towards borrowing any longer – was not worth the risk because it led to an economic crisis that could be prevented if these inflows were regulated by the state. When the international crisis escalated at the end of the 1970s and the borrowing of the private firms declined, the military had to take over the liabilities of the debt and make the public enterprises increase their loans with the international banks in order to try to push for economic growth. The debt-led model of growth depended on the international conditions. The fact that the authorities in Brazil decided to

⁴ The first edition of Cruz's book was published in 1984.

rely on this form of funding left the country's economy vulnerable to external conditions, for any change in the international scenario could imply a decline in the foreign credit supply. And because the government did not plan for a decline in the credit supply, the Brazilian economy suffered drastically the consequences of a deep international economic crisis.

Our goal is to examine the deepening of the Brazilian domestic market opening with the focus on the foreign borrowing that private and public companies situated in Brazil made from the Eurocurrency markets. In order to do so this work resorted to bibliography that had previously discussed the debt crisis and the period between 1964 and 1983. The studies of Paulo Davidoff Cruz, Claudia Guimarães, José Eduardo de Carvalho Pereira, Antônio Claudio Sochaczewski, Maria Lucia Lima, Thomas Skidmore, Jeffry Frieden, Fabio Antonio de Campos, Carlos Lessa and Monica Baer were examined and provided this work with background on the literature that was written about the progress of the Brazilian indebtedness under military rule. In addition, this work examined bulletins and reports from *Banco Central do Brasil*, which provided the data on the composition of the Brazilian foreign debt during the 1970s.

First of all, it was crucial for this work to understand the emergence and growth of the Euromarkets. In *Banking on the World*, Frieden discusses the changes in the American finance system throughout the years, and the contribution of Frieden's work for this study becomes evident when he examines the expansion of the Euromarkets and the involvement of the American banks in its growth. Frieden argues that in the aftermath of Second World War, the possibilities for a revival of private international finance were wider in Europe. In this environment the Eurocurrency markets emerged. The regulations of capital in the US imposed by the Kennedy administration pushed American banks to these unregulated Euromarkets. Strengthening their offshore branches, the American banks would be able to lend capital with

fewer restrictions. In other works quoted here, Frieden is also going to study the relationship of indebtedness between Brazil's private and public sectors and the international banking system. The contribution of Maria Lucia Lima's thesis to this work consists in her account of the emergence of the Eurocurrency markets. Her study examines the process of internationalization of private banking and how the grouping of these banks abroad converged in the formation of the Euromarkets. Both of these studies help us understand the conditions in which these markets were formed and that the capital that moved within them was looking for growth opportunities and potential markets to invest.

The works of Guimarães, Sochaczewski, Pereira, Campos and Cruz discuss the implications of the changes in legislation that the military regime established, which were responsible for opening further the Brazilian internal market to external sources of credit. Guimarães' dissertation discusses the changes in legislation that were institutionalized with PAEG (*Programa de Ação Econômica do Governo*). This author explains the effort of the military in modernizing the Brazilian funding system in order to enable the modernization and development of the economy, and especially industry. Guimarães' work helps us understand that in order to promote economic growth, the government needed to develop new forms of credit creation and funding intermediation. In *Desenvolvimento Econômico e Financeiro do Brasil*, Sochaczewski's effort is to explain the changes in the Brazilian economic and financial system from 1952 until 1968. For the purposes of the present study, Sochaczewski helps us understand the lagging of the Brazilian economic and financial apparatus and how it needed to be transformed in order to allow the economic changes envisioned by the military authorities. Both of these studies address specifically the first years of the military regime.

Campos' dissertation discusses the general movement of the foreign direct investment from the 1950s until 1990, arguing that the dominance of the foreign capital in the development of the Brazilian industry was harmful to the nation. For the author this process assured the continuance of the dependency and underdevelopment of the Brazilian economy. The importance of this work to the present study is that it provides the historical background for the process of internationalization of the Brazilian economy during the military dictatorship. Campos is one of the authors that studied the importance of the foreign firms borrowing from the Eurocurrency markets in the end of the 1960s and beginning of the 1970s. This author shows how the Brazilian government's policies that allowed easy access to the international credit privileged these firms. In addition, Campos discusses the process of debt relief of the multinationals during the mid-1970s, and the attempt and failure of the government in reversing this process by offering the Brazilian Central Bank to hedge their loans in order to secure them from currency devaluations.

José Eduardo de Carvalho Pereira's study is different from the previous authors discussed in the sense that it was written in 1974, in the middle of the processes that this work discusses, and because it was written as a report for the Brazilian Institute of Economic and Social Planning (IPEA). Using reports from the Brazilian Central Bank, Pereira describes and analyses the participation of foreign credit in Brazilian economic growth during the period between 1966 and 1973. This is one of the most valuable sources for this work, because it provides data for the period in which the Brazilian economy grew at most extraordinary rates. Pereira's report helps us understand the importance of the measures created with PAEG in facilitating the entrance of private foreign capital in Brazil in the form of loans. It is important to understand this because when the economic crisis deepened in the 1980s and the Brazilian foreign debt exceeded a hundred billion dollars, it is crucial to know that this debt was held with private international

banks and that the Brazilian state would own the payment of the debt and its service to these private banks.

Directly related and crucial for this study, is Davidoff Cruz's works on the progress of Brazilian indebtedness during the 1970s and the process of nationalization of the debt in the mid 1970s. *Dívida Externa e Política Econômica* discusses the nature of the deficits in the current account and the relationship of these deficits with foreign borrowing. In this study the government's rhetoric on the "gap of resources" is central for the author because it determined the impulse towards the expansion of borrowing with private foreign sources. Cruz's article entitled *Endividamento Externo e Transferência de Recursos Reais ao Exterior* discusses deeper one of the periods that he had briefly discussed in his previous publication, which is the end of the 1970s and the time of the nationalization of the debt. This article is fundamental for our study because it draws a direct relationship between the nationalization of the debt and the crisis of the Brazilian state during the 1980s. Cruz's article speaks directly to our thesis because it shows the infeasibility of the Brazilian government effort to push for indebtedness.

If Guimarães, Sochaczewski, and Pereira were crucial for understanding the measures implemented by the Castelo Branco economic team formed by Roberto Campos and Bulhões, Carlos Lessa's work helped us understand the implementation of the Geisel economic plan, called II PND, and its consequences. Lessa describes Geisel's effort in rearranging the government's priorities towards industry and in making the production of equipment and machinery the leading sectors of the economy. The author also discusses the reasons for the failure of the plan, access to credit being one of them.

Thomas Skidmore contextualizes the economic and financial situation in Brazil with the political scenario in *The Politics of Military Rule in Brazil*. This work is important to understand

the projects of the military for the Brazilian society. Within the idea of development and modernization of the national economy, Skidmore shows the “civilizing mission” that the military thought they were responsible for, and all the disagreements and conflicts that there were within the military. For the purposes of the present work, Skidmore’s book showed the environment in which the borrowing was made and the political decisions that influenced the economic and financial transformations in the country.

At last, this work discusses the ways in which the Brazilian government decided to handle the payment of the debt, and to argue about this subject this work relied greatly on Monica Baer’s study entitled *O Rumo perdido: a crise fiscal e financeira do Estado Brasileiro*. Baer argues that when the Brazilian authorities agreed to subject the fiscal and monetary policies to meet specific targets set by the IMF, the nation lost control of how it could manage the crisis. For this work, Baer’s description of how the IMF was allied with the international private banks is essential. As the author explains, the IMF was the manager of the crisis, and it served as the advocate of the foreign banks.

The study of these works and the data found Banco do Brasil’s bulletins and reports will, therefore, help us understand the explanations and consequences of this moment of Brazilian indebtedness with the Eurocurrency markets. In the first chapter this work will analyze the emergence of the Euromarkets and the eagerness of the military to have access to these funds. In the second chapter this work will focus on the study of the period of greatest economic growth in Brazil, the influence of the foreign funds in this growth and which were the economic sectors mostly responsible for indebtedness from 1968 until 1973. At last, this work will evaluate the consequences of a decade of intense borrowing with private international banks for Brazil, and how the country’s authorities handled the crisis in the beginning of the 1980s.

CHAPTER 1

THE INTERNATIONAL FINANCIAL CLIMATE AND THE MILITARY RESPONSES TO THE 1960S CRISIS

The João Goulart government faced a period of intense economic and political crisis in the beginning of the 1960s. Economically, the government was challenged with an increasing inflation and deficit in the Balance of Payments, and in the political sphere, opposing strata of the society demanded different actions from the state. Pressured by the progressive political parties, unions, rural movements, and students, the Goulart government started to fight for capital regulation, basic reforms⁵, and the enlargement of social rights. Because the majority in congress did not approve of the Goulart reforms, he started to induce rallies to motivate the population's participation in order to pressure the Congress⁶.

The opposition, however, would not allow Goulart reforms to come into effect. The conservative strata of the Brazilian society that were against these projects that tended to promote policies of capitalism regulation, and that were formed by bankers, businessmen and big landowners, joined the military in the promotion of a coup in order to prevent the Goulart government from implementing its projects⁷. The dictatorship narrowed down the possibility of change and put into effect the modernizing project for Brazil that was defended by the conservatives. New legislation and a change in the international sources of funding would enable the model of development desired by this group to come into effect.

⁵ These reforms varied from agricultural land reform, to the creation of public schools, and the elevation of basic wages.

⁶ Thomas Skidmore, *Politics of Military Rule in Brazil, 1964-1985* (New York: Oxford University Press, 1988), 15.

⁷ João Manuel Cardoso de Mello and Fernando Novais, *Capitalismo Tardio e Sociabilidade Moderna*, (São Paulo: Editora UNESP, 2009), 53.

1.1 The Eurocurrency Markets and their interest in Brazil and Latin America

In order to understand how the project of development planned by the military came into effect, it is crucial to briefly look into the emergence of the Eurocurrency markets. This market that arose during the 1960s as a new international financial concept was defined as a space that held currency outside its country of issue⁸, and represented the source of the international funds responsible for the increase of the Brazilian foreign debt during the 1960s and the 1970s.

Jeffry Frieden argues that American international finance was relatively inactive during the 1930s and 1940s⁹. After the 1950s and the reconstruction of Europe in the aftermath of Second World War, the possibilities for a revival of private international finance were wider, and in the 1960s it took a turn toward the offshore markets, also known as Eurocurrency markets or Euromarkets. As Frieden claims, “soon hundreds of billions of dollars were flowing untrammelled across borders with a speed and fluidity that even America’s most optimistic international bankers could not have imagined in the 1930s and 1940s”¹⁰.

The Euromarkets emerged during the 1950s as the result of the Soviet Union’s and China’s deposits. Afraid the American government would seize their capital if sent to the United States, instead of depositing the profits earned from the international trade in the US, these countries deposited them in the banks that were operating in the Euromarkets¹¹. Later during the 1960s, the Euromarkets’ high interest rates attracted other depositors, such as the American corporations with subsidiaries in Europe that aimed to earn a better return on their dollars than they could in the United States. Because there was a crisis of oversupply of goods in the productive sphere, the companies started to “recycle” their profits in the sphere of international

⁸ Jeffry Frieden, *Banking on the World: the politics of American international finance* (New York: Harper & Row, 1988), 82.

⁹ Frieden, *Banking on the World*, 51.

¹⁰ Frieden, *Banking on the World*, 77.

¹¹ Frieden, *Banking on the World*, 81.

finance. Instead of reinvesting the profits in production they would invest this capital in the international banks. For François Chesnais this was the main element of expansion of the Eurocurrency markets, which brought an abrupt increase of the capital circulating in these markets already in the 1960s¹².

Meanwhile, in the United States, American lending to foreigners grew rapidly and the outflow of dollars out of the US increased drastically. Robert Bremner states that from 1956 until 1961 “a total of \$17 billion of US long and short-term private capital went abroad”, and that during 1960 and 1961 the US registered an outflow of capital of an average of \$3.9 billion and an average of only \$1.3 billion of capital inflows¹³. To prevent the continuity of this drainage of capital, the Kennedy administration imposed a change in Regulation Q establishing a tax on most foreign bonds issued in the US, and limiting the amount that banks in the US could lend to foreigners and that American corporations could send abroad to invest. Also, a measure that was called “Operation Twist”, and that was greatly pursued during Kennedy’s administration, consisted of determining a monetary policy that would “keep domestic long-term interest rates low while moving shorter term interest rates higher to minimize short-term capital outflows”¹⁴.

These regulations, however, instead of preventing American banks and corporations from sending dollars overseas sped the internationalization of American finance. They pushed American banks to the unregulated Euromarkets¹⁵. American banks strengthened their branches in Europe to attract dollar deposits and lend them there. About this, Jeffry Frieden concludes that the offshore dollar lending exploded as a response to restrictions on foreign lending in the US,

¹² Chesnais, “A Globalização e o curso do capitalismo”, 19.

¹³ Robert Bremner, *Chairman of the Fed: William McChesney Martin Jr. and the creation of the modern American financial System* (London: Yale University Press, 2004), 166.

¹⁴ Karel Hobik, “United States Balance of Payments Deficit and Monetary Policy”. *Weltwirtschaftliches Archiv*, Bd 103 (1969): 172.

¹⁵ Frieden, *Banking on the World*, 84.

implying that American banks were the main institutions responsible for the growth of the Eurocurrency markets during the 1960s.

A crucial characteristic of this international finance is its relative freedom from national government interference. The Euromarkets created an international financial circuit that had its own characteristics and high rates of autonomy when compared to the national financial markets¹⁶. As Frieden states, the lending process before the advent of the Euromarkets was to a great extent a part of national economies¹⁷. However, in the Euromarket, investors, borrowers, and banks were tied in a network that was part of no national financial system and, at the same time, part of them all. Because the banks in the offshore markets were usually free from national regulations, they could charge less to the borrowers and use the latest financial innovations, for example – without securing their governments approval beforehand. As Frieden interprets, “the combination of state-of-the-art technology and relative freedom from government interference makes the offshore markets the financial marketplace of choice for the world’s leading banks and corporations”¹⁸.

Despite the great expansion of these markets, during the 1950s and in the beginning of the 1960s the offshore banks were not yet interested in lending to Brazil. Up until 1968, the international banks found it too risky to invest in an economy that had very low rates of growth. Because they were looking for opportunities that would provide them with high rates of profit, Brazil was not an option, yet. As this work will show in the next chapter, this scenario would change in 1968.

¹⁶ Maria Lucia L. M. P. Lima, “O Euromercado e a Expansão do Capital Financeiro Internacional” (Masters thesis, Universidade Estadual de Campinas, 1985), 63.

¹⁷ Frieden, *Banking on the World*, 90.

¹⁸ Frieden, *Banking on the World*, 91.

1.2 Financial Reforms

In order to establish in Brazil the development model that was envisioned by the military elites, the government created new forms of credit creation and funding intermediation. The idea was to give the firms in the country access to internal and external sources of credit. Already aware of what was happening in the offshore markets and eager to tap into this great liquidity, the Brazilian military government proposed a plan to attract foreign investments to the country and to prepare the Brazilian financial internal market for receiving these funds. Already in 1964 the Brazilian government institutionalized the *Programa de Ação Econômica do Governo*, PAEG.

PAEG's guidelines proposed that this plan would be committed to fighting inflation and correcting the distortions in the systems of price, in speeding up the modernization of the social and economic structure of the country, and with long-term planning. Its main goals were to reduce inflation, to enforce the economic growth that was interrupted in 1962, to alleviate sectorial and regional imbalances and tensions created by social inequality, to assure productive employment, and to restore the viability of the Balance of Payments¹⁹.

From 1964 until 1966, 848 laws, 5685 decrees, 3 institutional acts, 24 complementary acts, 58 memorandums from the Central Bank, and 41 Resolutions, among other measures, were established²⁰. Some of these measures will be discussed here because they represented the legal instruments responsible for connecting the Brazilian internal market to the foreign resources. Before advancing further with the analysis of the legal measures that facilitated borrowing from the Euromarkets, it is important to state here that the Brazilian government was willing to attract

¹⁹ Mario Henrique Simonsen, and Roberto de Oliveira Campos, *A Nova Economia Brasileira* (Rio de Janeiro: José Olympio, 1975), 61.

²⁰ Antonio Claudio Sochaczewski, *Desenvolvimento Econômico e Financeiro do Brasil 1952–1968* (São Paulo: Trajetória Cultural, 1993), 235.

several forms of foreign investment, such as foreign direct investments, and even suppliers' credits. However, this work is going to focus specifically on foreign loans, the measures that facilitated their entrance in Brazil and the consequences of their massive inflows²¹.

The first legal change to be analyzed here is the one introduced in 1964 by Law 4.390 that presented a shift in Law 4.131, enacted by João Goulart in 1962. The Goulart government was facing a problem of increased profit remittances, which in 1960 reached the value of \$646 million²². This represented a problem to the government because the profits were being sent to the multinationals headquarters instead of being reinvested in the Brazilian economy. In order to control these remittances, Goulart created Law 4.131, which established that no more than 10 percent of the profits originated from the initial capital that was invested could be remitted, and forbade the subsidiary firms to remit to their headquarters the profits that arose from reinvestments²³. In addition, Law 4.131 would regulate the influx of all foreign capital that would enter the country and the total of the international financial transactions²⁴.

With the advent of Law 4.390 the limits to profit remittances were loosened. The most important changes that came with Law 4.390 were the revocation of articles 31, 32 and 33 from Law 4.131. In summary, the three articles determined that the value of profit remittances could not exceed 10 percent of the value of the initial investments, and that the foreign capital portion of annual return could not exceed 12 percent of the registered capital²⁵. This change approved that an aliquot of twelve percent of all the capital invested – the initial capital and also the one

²¹ For further information about the study of foreign direct investment in Brazil see Fabio Antonio de Campos, "A Arte da Conquista: o capital internacional no desenvolvimento capitalista brasileiro (1951-1992)" (Ph.D. diss., Universidade Estadual de Campinas, 2009).

²² Sochaczewski, *Desenvolvimento Econômico e Financeiro*, 166.

²³ Campos, "A Arte da Conquista", 143.

²⁴ José Eduardo de Carvalho Pereira, *Financiamento externo e crescimento econômico no Brasil: 1966/73* (Rio de Janeiro: IPEA/ INPES, 1974), 19.

²⁵ (Banco Central do Brasil, Lei 4.131)

that was product of the reinvestments – could be remitted to the headquarters. Despite still imposing a limit to profit remittances, this law did not put a limit on the payment of interest rates and amortization from foreign loans²⁶. The net result of this change was that the foreign firms were encouraged to invest in Brazil because they would be able to remit a higher value of profits than they had being remitting during the previous governments. In addition, even though there was a limit in the value that they could remit, they could forward the profits to the headquarters by claiming they were paying interest rates and amortization from foreign loans. Therefore, the multinationals could remit more than the twelve percent of all the capital invested by declaring they were not profit remittances, but payment for the service of the debt.

The motivation of the military government was that Law 4.390 would stimulate a rapid increase in private foreign investment that would bring technology and improve the balance of payments. The Brazilian *Veja* magazine stated in 1969 that the intention of the Brazilian government economic team in changing the law that regulated profit remittances was to provide an attractive environment for the foreign capital²⁷. In addition, the dictatorship also believed that the fact that they were benefiting foreign investors in Brazil would help them to convince the US government and the international agencies that Brazil was committed to the free world economy²⁸. Therefore, the law was also a symbolic gesture from the military regime. Law 4.390 served as a booster for foreign loans. For Frieden, it tended to favor foreign companies and public enterprises because they had “preferential access to the Euromarkets due to the size and creditworthiness of the ultimate guarantor of the loan” – which were the headquarters, in the case of the multinationals, and the Brazilian government, in the case of the parastatals²⁹. This would

²⁶ Campos, “A Arte da Conquista”, 145.

²⁷ “Brasil-EUA no Jogo da Verdade”, *Veja*, November 5, 1969, 23.

²⁸ Skidmore, *Politics of Military Rule in Brazil*, 36.

²⁹ Frieden, “The Brazilian Borrowing Experience”, 102.

already indicate which would be the firms that contracted most of the debt throughout the end of the 1960s and 1970s.

Another measure, Instruction 289 introduced in 1965, allowed industrial or commercial firms in the country to borrow directly from external banks. It was created in order to increase the supply of working capital to the firms in Brazil. Pereira claims that Instruction 289 was shaped to substitute for swap loans because “difficulties in the balance of payments reduced companies’ capacity to import, which led the monetary authorities to allow the short-term inflows of foreign currency”³⁰. This measure made it possible for the *Banco do Brasil’s* foreign exchange portfolio (or *Carteira de Câmbio do Banco do Brasil*) to purchase foreign currency; establishing for the seller the right to a currency hedging to the foreign currency return. The benefits that this law gave to the multinationals were explained by the direct and simplified intermediation of the subsidiary to access foreign loans with the international banks³¹.

The PAEG also created Law 4.728. One of the functions of this law was to give the investment banks the responsibility to supply long-term credit in order to provide the financial system with more agile forms of fund raising. This would be an essential measure when it came to the entrance of the funds from the Euromarkets in the country. These investment banks would become responsible for one of the forms of intermediation between the international banks and the firms that got the loans³². More than being responsible for long-term credit supply, they ended up becoming great sources of working capital to firms, and intermediaries of public and external funds³³.

³⁰ Pereira, *Financiamento externo e crescimento econômico*, 22.

³¹ Campos, “A Arte da Conquista”, 146.

³² Claudia Guimarães, “1964, Estado e Economia: a nova relação” (Ph.D. diss., Universidade Estadual de Campinas, 1990), 127.

³³ Lúcia Goldenstein, *Repensando a Dependência* (Rio de Janeiro: Paz e Terra, 1994), 70.

In addition, Law 4.728 allowed the financial institutions to pay the value of the monetary correction to their shareholders above the interest rates agreed upon, in order to prevent inflation from jeopardizing the appreciation of public bonds. Because the idea was to fight and end inflation, this measure would be provisional and would be abolished proportionally to the decrease of inflation rates³⁴. Even though inflation decreased from 90 percent in 1964 to 39 percent in 1966, it was not quelled. When the Brazilian economy started to grow in 1968 this monetary correction prevailed, and inflation became an instrument of speculation. In other words, the shareholders started to bet on the appreciation of their bonds based on the increase of inflation, and because the short-term gains that originated with this were too great, the agents were not willing to wait for long-term gains that could come through the stock markets. This jeopardized the growth of the stock market and the capital market activities in Brazil³⁵.

As Skidmore explains, the lack of a central bank was a major institutional gap in the Brazilian economic system³⁶. The institutions that were meant to fulfill the functions of the central bank were *Banco do Brasil*, and *Superintendência da Moeda e do Crédito* (SUMOC). While the first used to be the lender to the public sector – and at the same time functioned as a commercial bank – the second was the agency that coordinated monetary policy. In 1965 the military created the Central Bank (BACEN) and the *Conselho Monetário Nacional* (CMN) aiming to centralize monetary policy³⁷. Even though it took several years for the BACEN to concentrate power, because the Banco do Brasil continued to influence monetary policy, the creation of a central bank would be of extreme importance, for all the problems regarding

³⁴ Guimarães, “1964, Estado e Economia”, 132.

³⁵ Guimarães, “1964, Estado e Economia”, 134

³⁶ Skidmore, *Politics of Military Rule in Brazil*, 30

³⁷ Guimarães, “1964, Estado e Economia”, 120

reserves and balance of payments deficit that reappeared during the 1970s would start to be handled by this bank.

In addition, of extreme importance to the purposes of this work was the creation of Resolution 63 in 1967. Through this resolution investment or private development banks, and commercial banks that were authorized to function in foreign exchange, would be able to contract foreign loans that would be passed directly to enterprises in the country³⁸. It allowed the foreign capital to be transferred by the investment banks, commercial banks, and by the BNDE (*Banco Nacional de Desenvolvimento Econômico*³⁹), sanctioning a direct financial intermediation between private enterprises in Brazil and the international credit market⁴⁰.

In order to complement all these measures created to stimulate the entrance of foreign funds in the country, the military government signed a treaty with the United States' government in which the Brazilian authorities were committed to compensating "justly" any expropriations of American-owned property that were invested in Brazil. If there were litigation on the value of the property, the decision would go to US courts (Sochaczewski, 1993, p. 241).

This revised legislation connected the interests of the multinationals and dominant classes to the foreign funds available at the Euromarkets. With this new legislation the industrial projects of the dominant classes would be able to be funded and come into effect – because the domestic funds would not be enough to achieve the desired goals to the Brazilian industry. New

³⁸ "Resolução 63", Banco Central do Brasil, accessed April 11, 2013.

http://www.bcb.gov.br/pre/normativos/res/1967/pdf/res_0063_v1_O.pdf

³⁹ The BNDE was a government agency created by Getúlio Vargas in 1952. It was a government bank and its purpose was to fund national industrial projects. "The BNDE thus became an essential factor in industrial expansion as well as a pivotal link in channeling foreign finance into Brazilian industry. With the BNDE accounting for four-fifths of industrial lending (much of it funded abroad) and over \$4 billion in guarantees for foreign borrowing by Brazilian firms since 1968, the BNDES and its supplementary network of state and regional development banks were at the heart of Brazil's indebted industrialization". Frieden, "The Brazilian Borrowing Experience", 110.

⁴⁰ Campos, "A Arte da Conquista", 147.

possibilities of funding were given to the private, and also public, firms in the country, which would be able to access the international banking system more easily.

Although these measures started to be set up in 1964, it was not until 1968 that the Brazilian internal market started to attract external resources effectively. Up until the end of this decade the external investor did not want to risk his funds in an economy that was still registering low growth rates. The expectations for profit rates and domestic market development were still low, and at this moment it did not matter how the Brazilian government was treating the foreign investor (Sochaczewski, 1993, p. 244). As Skidmore states, “business was looking for the prospect of economic growth, which alone could generate profits”, and in mid-1965, it was not clear whether the PAEG could achieve growth soon, “so private foreign investors remained cautious”⁴¹.

Nevertheless, the reforms established by the Program were of extreme importance because they created a favorable environment for foreign investments and funds. The PAEG opened the Brazilian market as never before. The Brazilian military government chose debt-led growth and allowed the corporations and firms in the country to grow and implement their modernizing projects with foreign capital. As Frieden claimed, “the Brazilian government, along with the private financial sector and the largest basic industrial firms, did everything possible to tap the expanding international financial markets”⁴². Even though this represented a promising project that would, and did, allow the modernization of the Brazilian industrial park, as this work will show, its consequences were devastating for the country.

⁴¹ Skidmore, *Politics of Military Rule in Brazil*, 38.

⁴² Frieden, “The Brazilian Borrowing Experience”, 104.

CHAPTER 2

FOREIGN LOANS AND DEBT-LED GROWTH

In 1966 foreign creditors operating through the Eurocurrency markets started to believe Brazil was “on the eve of a resurgence of growth”, an impression they got especially because of the reduction of inflation. Skidmore stated that in December 1965 the US government announced another \$150 million loan to be implemented through the USAID program, and “in February 1966, the IMF and the US reiterated their confidence with new financial commitments”⁴³. But it is important to notice here that up until 1967 Brazil had been borrowing mainly from foreign state agencies, and especially from the US government. Only after the Brazilian economy started to show real economic prospective growth would the private foreign investor restore his interest in the country. And this was what happened during 1967 and 1968, when after four years of economic recession Brazil recovered from the economic crisis, and its global growth rates reached 4.8 percent in 1967 and 11.2 percent in 1968⁴⁴. During the period between 1968 and 1974 the Brazilian gross domestic product grew an average rate of 9 percent a year⁴⁵.

Tavares and Assis argue that the conditions in which the Brazilian “economic miracle” would manifest itself were the production of durable consumer goods and the real estate market recovery that urged economic growth. In addition, even though the wages paid to a growing number of employees were low, they stimulated the demand for consumer goods⁴⁶. In another article, Tavares, together with Belluzzo, summarily attributes the recovery of Brazilian industry to the fiscal and financial reforms of 1966 that improved the funding conditions; to the increase

⁴³ Skidmore, *Politics of Military Rule in Brazil*, 55.

⁴⁴ Sochaczewski, *Desenvolvimento Econômico e Financeiro*, 252.

⁴⁵ Carlos Lessa, “Visão crítica do II PND”. *Revista Tibiriçá*, ano 2, n. 6 (1977): 49.

⁴⁶ Maria da Conceição Tavares and José Carlos de Assis, *O Grande Salto para o Caos* (Rio de Janeiro: Jorge Zahar, 1985), 27.

and restructuring of the prices of public utilities that encouraged the power transmission project; to the consumer credit program linked to the monetary adjustment, which encouraged the demand of several durable consumer goods; to the program of house loans (or *Sistema Financeiro de Habitação*) that encouraged civil construction; to the incentives to exports that involved subsidies to the textile production and machinery; and to the wage and funding policies that motivated the consumption of the upper-middle class. For these authors, all these policies had great impact on employment and on the increase of urban income⁴⁷.

Lessa claims that during the period between 1966 and 1969, the industry of capital goods in Brazil grew an average of 7.5 percent a year, and between 1970 and 1973, it grew an average of 27 percent a year. The industry of durable consumer goods, in its turn, grew an average of 16.2 percent between 1966 and 1969, and 18.4 percent between 1970 and 1973. In addition, the industry of non-durable goods grew 8.4 between 1966 and 1969, and 7.2 percent between 1970 and 1973. Finally, intermediate goods grew 9.5 percent between 1966 and 1969, and 11.4 percent between 1970 and 1973⁴⁸. In this scenario of industrial economic progress, foreign loans would be greatly responsible for providing the funds that would give rise and safeguard this growth. Frieden claims that this industrial expansion was greatly financed by borrowing. He argues that “some of the expansion was financed by new injections of equity from local affiliates of foreign corporations, but even for foreign-owned corporations, borrowing abroad was often more attractive than direct investment by the home office”⁴⁹.

⁴⁷ Maria da Conceição Tavares and Luiz Gonzaga Belluzzo, “Notas sobre o Processo de Industrialização recente no Brasil” In *Desenvolvimento Capitalista no Brasil: Ensaio sobre a Crise*, v. 1, edited by Belluzzo and Coutinho (Campinas: IE/UNICAMP, 1998), 14.

⁴⁸ Lessa, “Visão crítica do II PND”, 50.

⁴⁹ Frieden, “The Brazilian Borrowing Experience”, 113.

The new investment programs of the state companies relied on loans that came from overseas “in almost every case”⁵⁰. One example that illustrates this point is the energy sector in Brazil. Only about 30 percent of the investment funds to finance *Eletróbrás*, *Itaipú* and *Nuclebrás* came from net operating income. According to Frieden, “by the late 1970s, half of all investment was being financed by borrowing, almost all of it abroad”⁵¹.

2.1 Foreign Debt Increase and The Economic “Miracle”

In 1967, the administration of the federal government and the economic planning were changed. When Costa e Silva took office in 1967, Delfim Neto, a 38-year old economist from the city of São Paulo, substituted for Roberto Campos and Octávio Bulhões. The decisive aspect of this new administration for this study is that Delfim Neto changed the diagnosis of the cause of Brazilian inflation. If in 1964 the authorities claimed the Brazilian inflation was demand-induced, which was triggered by public sector deficits, excessive credit to the private sector and excessive wage increases, now, Delfim Neto argued that it was cost-push inflation. Here he claimed that the most important cost was credit, which was “further tightened in 1966-1967”⁵². Consequently, if the diagnosis were different, the prescription to end inflation would also be another one.

Delfim’s plan to fight inflation stated that an increase in the goods’ supply would be necessary in order for the demand to be matched, which would come through a expansionary monetary policy. The idea was to “stimulate demand by easing credit”⁵³. According to Delfim, the economic team intended to speed up the development process encouraging the private sector,

⁵⁰ Frieden, “The Brazilian Borrowing Experience”, 105.

⁵¹ Frieden, “The Brazilian Borrowing Experience”, 106.

⁵² Skidmore, *Politics of Military Rule in Brazil*, 69.

⁵³ Skidmore, *Politics of Military Rule in Brazil*, 70.

while the government would perform a supporting role. The measures “aimed to strengthen the stock market and, consequently, the private enterprises”⁵⁴. The government started to increase credit to the companies, releasing loans to the private sector, to control prices, especially the financial costs and input, and to stimulate demand in the sectors where the excess capacity was larger⁵⁵. This indicates that the government’s orientation was to inject liquidity into the Brazilian economy.

The domestic credit expansion would come together with an increase in the foreign currency inflows around 1968. This would favor Delfim’s plan, for the domestic institutions would be able to intermediate the borrowing between the international banks and the firms located in Brazil. The period between 1968 and 1973 would be characterized by the massive inflows of foreign resources to Brazil; a moment when the Euromarkets started to target Latin America and provide credit to underdeveloped countries that had good potential for expansion. The determinant characteristic of this period was this broader movement of the international capital that was benefiting Brazil, as all of Latin America, by seeing in the region a growth opportunity⁵⁶. This suggests that even though the military created measures to attract the international loans, the foreign creditors would have been willing to lend to Brazil even if the internal Brazilian legislation was not that favorable. Yet, the measures had been created, and, now, the international capital would start to use them to enter the country. An increase in borrowing from private international banks by firms in Brazil was established especially through

⁵⁴ “Uma Roupas Nova para Velhos Problemas”, *Veja*, January 15, 1969, 18.

⁵⁵ Sochaczewski, *Desenvolvimento Econômico e Financeiro*, 253

⁵⁶ Paulo Davidoff Cruz, *Dívida externa e política econômica: a experiência brasileira dos anos 70* (Campinas: IE/Unicamp, 1999), 24.

Law 4.131, Resolution 63 and Instruction 289⁵⁷. The reforms implanted by PAEG provided the institutional bases to the phase of growth that would mark the years between 1968 and 1973.

Some characteristics of this phase of the military government show that the country's economic growth during this period was greatly due to the expansionary monetary policy, and was not aided by other governmental policies. Delfim Neto centralized the control of taxes entirely in the federal government. His fiscal policy reduced in half the resource transfers to the states and counties. In addition, the domestic capital markets did not develop on solid foundations due to the competition from loan capital and the expansion of the finance market. As Tavares and Assis stated, the Brazilian economy during this period was driven dependent on “public funds, bureaucratic favors, and credit”⁵⁸.

It is also necessary to discuss here the military government's motivations to attract foreign loans. The massive support to the foreign indebtedness was emphasized by the official rhetoric by the end of the 1960s and beginning of the 1970s. The official discourse claimed that the foreign loans were a vital element to the viability of the high growth rates of the domestic product, for if Brazil tried to speed up its growth rates it would face restrictions on the external sector performance and on the internal savings. The rhetoric stated that there was a domestic “gap of resources” (or “*hiato de recursos*”) that would restrict economic growth. Foreign borrowing was, therefore, necessary for economic growth and the alternative to the absence of significant internal savings⁵⁹.

The other problem seen by the government was that these foreign loans were also necessary to bring equilibrium to the Brazilian Balance of Payments. The data of the Current

⁵⁷ It is important to state here that Instruction 289 was revoked in 1972. Therefore, after this date there would be a decline of the borrowing contracted through this decree.

⁵⁸ Tavares and Assis, *O Grande Salto para o Caos*, 30.

⁵⁹ Cruz, *Dívida externa e política econômica*, 39.

Account shows that from 1969 until 1973 imports increased. However, exports also increased, and they were able to guarantee the necessary reserves to balance the Current Account. From 1969 until 1973 the trade balance of the Current Account registered a deficit of only \$30 million⁶⁰. In addition, foreign direct investment also increased during this period. Together, the exports and the FDI were able to bring equilibrium to the Balance of Payments. Therefore, the rhetoric of the “gap of resources” was invalid for this period.

The consequence of the borrowing at this period was an incredible increase of the Brazilian international reserves, which was criticized by Brazilian economists in 1973. Luiz Gonzaga Belluzzo, from Universidade de Campinas, asserted that there were no motives to think of the entrance of foreign capital as a formula for complementing domestic savings. For him the factor that determined how much would be invested was not the previous volume of savings, but the decision of the firms that would have new savings once profits materialized. Edmar Lisboa Bacha, from Universidade de Brasília, also said that these high volumes of reserves did not allow an increase in the imports of capital goods in the same proportion that the dollars were entering Brazil, asserting that for him that this was not an efficient way of promoting development⁶¹. Meanwhile, Delfim Neto continued arguing that “when more resources are brought from abroad they allow a larger investment, the same level of consumption is maintained and the economy is accelerated”⁶².

2.2 Composition of the Debt

By the end of the 1960s the international movement of capital favored Latin America, and the Brazilian economy was one of the targets of the international financial capital that was

⁶⁰ Cruz, *Dívida externa e política econômica*, 23.

⁶¹ “Dívida, a longa história”, *Veja*, Junho 6, 1973, 78.

⁶² “Dívida, a longa história”, 76.

looking for opportunities of appreciation in markets of potential growth⁶³. Data found in *Banco do Brasil's* bulletins show that Law 4.131 – changed by Law 4.390 – and Resolution 63 were the two most important laws in the composition of the debt between 1969 and 1978. Table 1 shows how important was the creation of those laws, for the majority of the borrowing that was contracted from institutions in Brazil during the 1970s entered the country through Law 4.131 and Resolution 63. By the end of the 1960s Instruction 289 was also relevant in the composition of the debt; however, this law was revoked in 1972.

In 1969 the loans that entered the country through Law 4131 and Resolution 63 represented, respectively, 18.1 percent and 9.8 percent of the total debt. In 1974 these amounts increased to 45.5 percent and 19.3 percent, respectively. In 1975 loans in currency already represented 68.7 percent in the total debt. Table 1 shows that within the 1970s the loans in currency account increased its participation in the total debt and became responsible, at the end of the 1978, for almost 68 percent of the total debt in Brazil. By the end of 1969, most of the debt was divided between import financing and loans in currency, that, respectively, held 30.9 percent and 36.4 percent at this time. By 1971, loans in currency were already responsible for 48.3 percent of the debt, while in 1973 this value was worth 62.4 percent. In 1976 this value reached its peak, when 70 percent of the debt was derived from this category.

Within the category loans in currency, table 1 also shows that the categories in which most of the debt was held were Law 4.131 and Resolution 63. The increase of loans that originated from Law 4.131 was the most dramatic. In nine years the debt contracted via this law increased from \$ 798.7 million to \$ 22 billion, an increase of 2,775 percent. In what concerns Resolution 63, the increase of the debt via this category was also considerable. While in 1969 loans originated from this resolution were worth \$ 432.5 million and represented 9.8 percent of

⁶³ Cruz, *Dívida externa e política econômica*, 24.

the debt, in 1974 this value was accumulated on almost \$ 3 billion and a half, representing 19.3 percent of the total debt. From 1975 to 1978 the value of the debt contracted by this resolution continued increasing from \$ 3.7 billion in 1975 to over \$ 7 billion in 1978, yet the representation of this category in the total debt dropped slightly and settled in an average of 17 percent throughout these years.

Regarding the loans originated by Instruction 289, the data show a decline of loans originated by this category. By 1969, 8.5 percent of the Brazilian total debt was derived from this category, in 1972 the amount of the debt held by this category was worth 2.2 percent of the debt, and after 1973 the debt acquired by this law suffered a drastic decline, falling to 0.5 percent of the total debt in 1973 and 0.2 percent 1975. The main reason for this declined was that Instruction 289 was revoked in 1972⁶⁴.

The analysis of this data helps us to understand the characteristics of the Brazilian increasing debt. The type of borrowing that was mostly causing the increase of the total debt was the kind that was entering the country through Law 4.131 and Resolution 63. These data show the greater increase of the debt that was contracted from international private banks⁶⁵; it indicates that throughout the 1970s the proportions of the increase of the debt in these categories were much higher than in the other categories. While the *Banco Central* registered an increase from \$ 1.7 billion in 1970 to \$ 6.5 billion in import financing category, in loans in currency category this increase went from \$ 2.2 billion in 1970 to \$ 18 billion in 1976.

⁶⁴ Pereira, *Financiamento externo e crescimento econômico*, 20.

⁶⁵ Most of the debt by the end of the period was held with private international institutions, and this complicated the terms of its renegotiation the 1980s, for a negotiation from government to government, such as in the case of the funds from the USAID for example, would facilitate the process of renegotiation

Table 1: Brazilian External Debt (\$ million)

	1969		1970		1971		1972		1973	
	Value	%	Value	%	Value	%	Value	%	Value	%
1 - Compensatory Loans	548.4	12.4	381.8	7.2	300.6	4.5	240.9	2.5	203.3	1.6
2 - USAID - Program Loans	564.8	12.8	603.6	11.4	622.8	9.4	617.8	6.5	614.5	4.8
3 - Imports Financing	1355.2	30.9	1709.3	32.2	2201.5	33.3	2783.8	29.2	3486.8	27.7
3.1 - International Entities	363.9	8.3	456	8.6	576.2	8.7	762.1	8	971.8	7.7
World Bank	198.8	4.5	258.2	4.6	347.5	5.2	483.9	8	646.9	5.1
Interamerican Development Bank	151	3.5	181.4	3.4	206.1	3.1	243.7	2.6	277.1	2.2
International Finance Corporation	14.1	0.3	16.4	0.3	22.6	0.3	34.5	0.4	47.8	0.3
3.2 - Government Agencies	543.9	12.4	642.5	12.1	780.2	11.8	886	9.3	1072.8	8.5
3.3 - Other	447.4	10.2	610.8	11.5	845.2	12.8	1135.7	11.8	1442.2	11.4
4 - Consolidated Public Debt	16.1	0.4	15	0.3	13.9	0.2	12.2	0.1	10.4	0.08
5 - Loans in Currency	1604.7	36.4	2284.6	43.1	3193	48.2	5528.3	58.2	7848.5	62.4
5.1 - Resolução 63, of August 21, 1967	432.5	9.8	653.2	12.3	983.3	14.8	2018.4	21.2	2398.1	19
5.2 - Instrução 289, of January 14, 1965	373.5	8.5	381.2	7.2	294.8	4.5	207.4	2.2	71.1	0.5
5.3 - Lei 4.131, of September 3, 1962	798.7	18.1	1250.2	23.6	1914.9	28.9	3302.5	34.7	5379.3	42.7
6 - Other Loans	314.1	7.1	301.2	5.7	289.8	4.4	278	2.9	265.8	2.1
7 - Grand Total	4403.3	100	5295.2	100	6621.5	100	9521	100	12571.5	100

Source: Pereira, 1974, p. 93; Boletim do Banco Central do Brasil, maio 1979, p. 214, 215.

Table 1 (cont.)

	1974		1975		1976		1977		1978	
	Value	%	Value	%	Value	%	Value	%	Value	%
1 - Compensatory Loans	168.6	0.9	137.4	0.6	106.2	0.4	75	0.2	43.8	0.1
2 - USAID - Program Loans	610.4	3.5	600.5	2.8	585.8	2.2	569.8	1.7	551.4	1.2
3 - Imports Financing	4741.3	27.6	5464	25.8	6577.6	25.3	8422.3	26.2	10829.8	24.8
3.1 - International Entities	1388.4	8	1654.8	7.8	1993.3	7.6	2355.2	7.3	2885.3	6.6
World Bank	978.1	5.6	1094	5.1	1287	4.9	1540.4	4.8	1974	4.5
Interamerican Development Bank	311.7	1.8	416.3	1.9	545.9	2.1	624	1.9	731.2	1.6
International Finance Corporation	98.5	0.5	144.5	0.6	160.4	0.6	190.8	0.5	180.1	0.4
3.2 - Government Agencies	1541	8.9	1829.5	8.6	2170.4	8.3	2294.3	7.1	2601.7	5.9
3.3 - Other	1812	10.5	1979.7	9.3	2413.9	9.2	3772.8	11.7	5342.8	12.2
4 - Consolidated Public Debt	9.4	0.05	7.3	0.03	5.4	0.02	4.7	0.01	4.7	0.01
5 - Loans in Currency	11210.7	65.3	14561.1	68.7	18194	70	21528.4	67.1	29499.7	67.7
5.1 - Resolução 63, of August 21, 1967	3319.1	19.3	3734	17.6	4715.4	18.1	5239.8	16.3	7272.4	16.7
5.2 - Instrução 289, of January 14, 1965	68.9	0.4	46.1	0.2	40.9	0.1	26.8	0.08	27	0.06
5.3 - Lei 4.131, of September 3, 1962	7822.7	45.5	10781	50.9	13437.7	51.7	16261.8	50.7	22200.3	51
6 - Other Loans	253.2	1.4	240.3	1.1	227.7	0.8	214.6	0.6	201	0.4
7 - Grand Total	17165.7	100	21171.4	100	25985.4	100	32037.2	100	43510.7	100

Source: Pereira, 1974, p. 93; Boletim do Banco Central do Brasil, maio 1979, p. 214, 215.

The following diagram 1 shows two pie charts that reveal the percentages of the most important loan categories in the Brazilian debt account. These charts show that in 1969, the year that marked the beginning of the Brazilian “Economic Miracle”, the composition of the debt was relatively well distributed between loans in currency, imports financing and other loans. However, the 1975 chart shows that this composition was abruptly changed in the first half of the 1970s. In 1975 the composition of the debt was drastically concentrated in loans in currency. The fact that in 1969 the loans were not mainly concentrated in loans in currency category meant that the Brazilian debt was not contracted mostly from private international banks – as it was the case in 1975 – and that a significant part of it was held from governmental institutions. This was a better scenario because it gave Brazil a possibility of renegotiating the debt with governments, in a relationship from sovereign nation to sovereign nation, instead of having to deal with private banks – as it became to be the case in the 1980s.

The composition of the debt that was marked by foreign currency loans starting in 1968 was completely distinct from previous periods. As Pereira argues, from the end of the Second World War until 1968, the foreign capital influx to Brazil was mainly composed of import financing, direct investments and compensatory capital; during this period international currency loans were practically inexistent⁶⁶. While in 1966 53 percent of foreign capital that the industry absorbed were import financing, as of 1968 currency loans became predominant: 79 percent of the capital flows registered in 1971 were foreign loans⁶⁷.

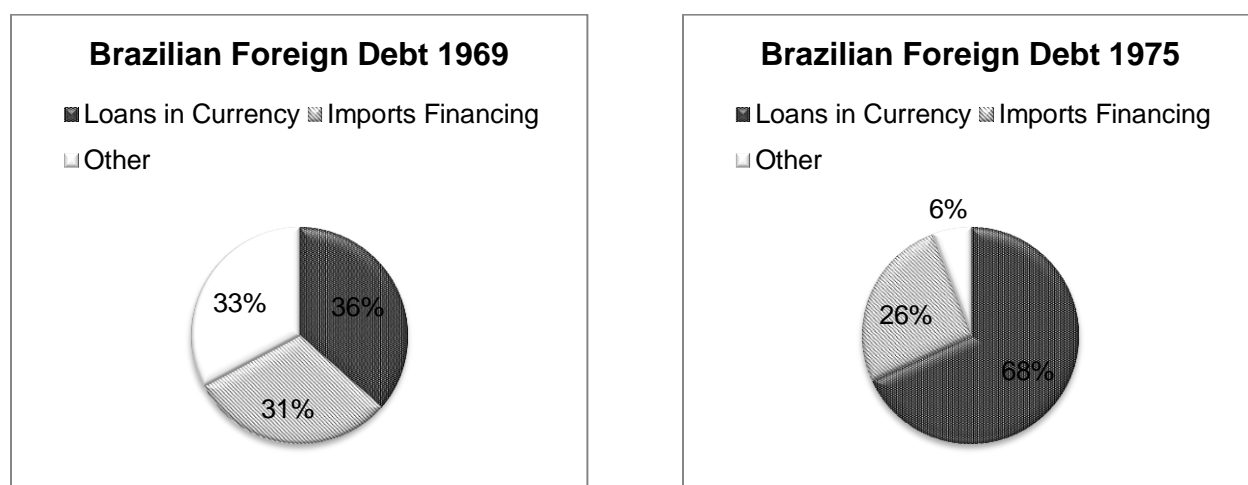
As Table 1 shows, in 1975, 68.7 percent of the total debt that was registered in loans in currency, of which 17.6 percent was coming from loans registered through Resolution 63, and 50.9 percent came from loans registered through Law 4.131. This shows that by 1975, 68 percent

⁶⁶ Pereira, *Financiamento externo e crescimento econômico*, 183.

⁶⁷ Pereira, *Financiamento externo e crescimento econômico*, 167.

of the Brazilian total foreign debt was lent by private institutions. During the 1970s, when the indebted were still able to roll over this debt, this would not be a problem. However, this would become problematic during the 1980s, after the US Federal Reserve Bank president Paul Volcker increased drastically US interest rates, which made the Brazilian debt with the international private markets triple in its value.

Diagram 1: Brazilian Foreign Debt (1969 and 1975)



Source: *Boletim do Banco Central do Brasil* março 1976, v.12, n. 3, Brasília

The international banks of US origin were predominant among the lenders, and were responsible for 29 percent of the lending in 1968 and 35 percent in 1971. The United Kingdom banks followed the North-American banks (lender of 13.5 percent of the Brazilian debt in 1971), France (9 percent in 1971), and then came the German banks (7.3 percent in 1971), and the Belgian banks (6.5 percent in 1971)⁶⁸. In addition, during the period of the “economic miracle” the main borrowers in the industry sector were the chemistry, mechanics, electric material, communication, and transportation sectors⁶⁹.

⁶⁸ Pereira, *Financiamento externo e crescimento econômico*, 174.

⁶⁹ Pereira, *Financiamento externo e crescimento econômico*, 167.

2.3 Private versus Public Borrowing

The role of BNDE in the Brazilian indebtedness was important, as it guaranteed the foreign borrowing by public and private firms. Frieden claims that between 1968 and 1973, this state bank intermediated an average of \$90 million a year. During the years 1974 until 1980 this average increased to \$500 million a year⁷⁰. The BNDE became fundamental to channeling foreign currency into the Brazilian industry and it was responsible for 80 percent of the industrial lending during this period⁷¹.

Even though public borrowing increased drastically during the 1970s, as it will be discussed in the next chapter, the end of the 1960s and beginning of the 1970s was marked by the high rates of private firm borrowing. More than just private borrowing, however, what marked the period of the Brazilian “economic miracle” was that the multinational companies in the country were responsible for 54 percent of the foreign loans⁷². Pereira’s study for IPEA (or *Instituto de Planejamento Econômico e Social*), which covers only the first phase of the borrowing period we are studying here, discusses that the multinational firms situated in Brazil were the main institutions responsible for the Brazilian debt. He argues that a high increase of the indebtedness in the industrial sector could be observed amongst the foreign firms, that in 1966 were responsible for 44.2 percent of the total debt acquired, and that in 1971 were already accountable for 60 percent of the debt⁷³.

Davidoff Cruz explains that the foreign credit was so appealing to the big enterprises during this moment of Brazilian economic development because of some specific reasons⁷⁴. First

⁷⁰ Frieden, “The Brazilian Borrowing Experience”, 109.

⁷¹ Frieden, “The Brazilian Borrowing Experience”, 110.

⁷² Campos, “A Arte da Conquista”, 72.

⁷³ Pereira, *Financiamento externo e crescimento econômico*, 169.

⁷⁴ Cruz, “Endividamento Externo e Transferência de Recursos Reais para o Exterior: os setores público e privado na crise dos anos 80”. *Revista Nova Economia, UFMG*, v. 4, n. 1 (1995): 124.

of all, it represented a good option for long-term borrowing – something that the internal market was not able to do. Secondly, it represented a relatively low-cost form of credit. In addition, the author claims that the subsidiaries of great enterprises received additional benefits because they had the option of borrowing from abroad through preferential interest rates obtained directly by their headquarters in the Euromarkets, and because there was a greater permissiveness of the legislation regarding profit remittances for loans, they could, and did, substitute substantial volumes of direct investment for loans from abroad.

Jeffrey Frieden argues that most of the private borrowing was done by multinationals, “who made gross borrowings of nearly \$15 billion between 1972 and 1980”. In addition he states that this value was much larger than the sum of the foreign direct investment in the period, which indicates how important the foreign loans were with the Euromarkets. Regarding the domestic private firms, the author says that they borrowed about \$3.5 billion gross between 1972 and 1980 under Law 4131, but that most of their investment financing came from the BNDE or from private banks that lent capital through Resolution 63⁷⁵.

The public sector, in its turn, was accountable for 46.4 percent of the total debt in 1966, but for only 13 percent in 1968, and 3.9 percent in 1971⁷⁶. Regarding the public sector’s borrowing, it is important to remember here that in 1966 Brazil had been borrowing mainly from foreign state agencies, especially from the US government. In other words, the 46.4 percent of the debt for which the public sector was accountable was not mainly lent by the international private banks, but by international entities.

⁷⁵ Frieden, “The Brazilian Borrowing Experience”, 114.

⁷⁶ Pereira, *Financiamento externo e crescimento econômico*, 170.

CHAPTER 3

INTERNATIONAL ECONOMIC CRISIS AND ITS CONSEQUENCES TO THE BRAZILIAN ECONOMY

During the mid-1970s the international scenario of credit abundance would change. The international crisis that was marked by the first oil crisis and the crisis of the dollar-gold standard would influence a change in the supply of resources of the Euromarkets and would result in the end of the Bretton Woods agreement. As Lima argues, the abrupt change of the relative prices of the main commodities, allied with the crisis of the international monetary system provided the basis for the eruption of the first crisis of the Euromarkets⁷⁷. The real growth rates of the Eurocurrency markets, regarding the supply of liquid resources, decreased from 36.8 percent in 1973, to 21.1 percent in 1974, and it reached 6.5 percent in 1975⁷⁸.

Celso Furtado claims that this was probably one of the only times in history when a central international change gave prior notice, for the quadrupling in the oil prices “was more than herald for the bad times that were about to come”⁷⁹. Even though the scenario was of international economic crisis, the Brazilian military government, now under the presidency of Ernesto Geisel, would not respond by accepting the fact that Brazil would start to face lower rates of economic growth. Even though the economists from the Geisel administration probably knew that the international scenario of economic instability would affect Brazil negatively, their rhetoric that the Brazilian economy was an “island of tranquility amid a stormy sea”, and would

⁷⁷ Lima, “O Euromercado e a Expansão do Capital Financeiro Internacional”, 162.

⁷⁸ Lima, “O Euromercado e a Expansão do Capital Financeiro Internacional”, 169.

⁷⁹ Celso Furtado, *A Nova Dependência: dívida externa e monetarismo*. (Rio de Janeiro: Paz e Terra, 1982), 32.

respond to the crisis with accelerated growth⁸⁰. This government not only did not believe the international crisis would affect Brazil; it also counted on the continuance of the foreign loans to implement a new and ambitious economic plan.

Geisel believed that in the course of the Brazilian industrialization, gaps in the industry of basic inputs and capital goods were established. The Second Plan of National Development (or II PND) was then created to change the priorities of the Brazilian industrialization. If during the years of 1968 until 1973 the expansion was grounded on the growth of durable consumer goods, now the expansion would be based on the orientation that the economy should grow drawn by the sector that would produce the means of production. In this rearrangement of priorities basic industry – which involved the steel mill, the metallurgy of nonferrous metals, the basic chemistry, mining, and heavy electronics – and the production of equipment and machinery would become the leading sectors⁸¹.

The II PND was extremely ambitious, and even unrealistic; its idea was to maintain the growth rates achieved during the period 1968-1973 and preserve the high rates of export increase, and, at the same time, promote a radical rearrangement of industrial priorities⁸². It proposed that steel production would reach 18 million tons by 1980, when the country had taken fifty years to reach the production of 7 million tons of steel in 1974. In addition, the production of aluminum and zinc should increase from 100 tons to 300 tons, and from 15 thousand tons to 100 thousand tons, respectively, during the same period. The capital goods industry should also double by 1980, and the imports of machinery should decrease from 52 percent to 40 percent of

⁸⁰ Cruz, *Dívida externa e política econômica*, 48.

⁸¹ Lessa, “Visão crítica do II PND”, 52.

⁸² Lessa, “Visão crítica do II PND”, 53.

total machinery by 1978. The expectations for exports were also high. Brazil should be able to export around 200 million dollars in machinery and equipment by 1978⁸³.

This ambitious project assumed that the foreign resources that had fueled the “economic miracle” would continue to flow towards Brazil after 1974. Because this project involved the gradual reduction of imports, access to the foreign savings would enable Brazil to become less dependent upon the central economies⁸⁴. However, the international crisis proved to affect Brazil in several negative aspects. Already in 1974 Brazil would notice the consequences of the international crisis when, because of the increase in the oil prices, there was an increase of import prices, which led to deficits in the Trade Balance. Aiming to induce a decrease in the country’s imports, the government promoted a tight monetary policy that had the purpose of absorbing the “excess of liquidity” in the economy – a measure that would, from their perspective, cause a decline in the rates of imports⁸⁵. The imports, however, were not the only cause for worry. Against Geisel’s hopes, other negative aspects of the mid-1970s crisis were the insufficient inflows of foreign resources to Brazil. The *Banco Central* press officers pointed out on September 1974 that in comparison to the first semester of 1974, they had observed a reduction in the foreign loans inflows to Brazil during July and August⁸⁶.

During the years 1974-1976, the Brazilian Balance of Payments suffered current deficits, which accumulated to \$ 10.5 billion for the three years. As Davidoff Cruz explains, this was a consequence of the deterioration in the terms of trade and the decrease of the Brazilian exports’ volume – which were both consequences of the crisis of the developed economies⁸⁷. Regarding the imports, within only one year the value of the Brazilian imports doubled, going from \$6.2 to

⁸³ Lessa, “Visão crítica do II PND”, 52.

⁸⁴ Cruz, *Dívida externa e política econômica*, 42.

⁸⁵ Cruz, *Dívida externa e política econômica*, 51.

⁸⁶ Pereira, *Financiamento externo e crescimento econômico*, 39.

⁸⁷ Cruz, *Dívida externa e política econômica*, 25.

\$12.6 billion between 1973 and 1974⁸⁸. In the context of the II PND, the deficit in the trade balance was an even bigger problem because the foreign resources were not as available as they were previously. From 1974 the supply of foreign resources decreased, yet it did not cease completely.

Furtado claims that in 1974 the loans to the private sector experienced an expansion of 59.3 percent. He claims that during the mid-1970s the problems in the balance of payments started to threaten the Brazilian economic policy, for the deficit in the trade balance started to decline, yet the onus of the interest rates and amortization of the foreign debt increased drastically. In 1974 the services of the debt were worth 33 percent of the value of exports; however, in 1977 this value reached 51 percent. For Furtado, this was evidence that this debt would bring very negative consequences to the Brazilian economy from which nobody would be able to escape⁸⁹.

Ultimately, the Geisel government failed in implementing the II PND. The reasons for the failure were not only economic, but also political. Aside from the decrease of economic growth, the absence of massive capital inflows that would enable the implementation of the Plan, the abandonment of certain investments that were programmed and not implemented, and rising inflation⁹⁰, politically there were groups that were against the emphasis on the strengthening of the industry of capital goods and basic inputs. These were the producers of durable consumer goods. As Lessa argues, the change in priorities would “hurt the interests” of these strong sectors. In addition, already during the Geisel administration the discussion that the military should enter in a gradual process of re-democratization of its institutions emerged⁹¹.

⁸⁸ Furtado, *A Nova Dependência*, 32.

⁸⁹ Furtado, *A Nova Dependência*, 32.

⁹⁰ Campos, “A Arte da Conquista”, 91.

⁹¹ Lessa, “Visão crítica do II PND”, 60.

3.1 The “Nationalization of the Debt”

Knowing the circumstances of the international crisis, the multinational headquarters started to warn their subsidiaries to start getting rid of their debt in peripheral markets⁹². The national and multinational private firms, then, decided to slowdown their borrowing with international loans aiming for debt clearance. The problem was that the strategy of the private firms could harm the kind of economic model that was enabling Brazilian economic expansion since 1967: the debt-led growth. Therefore, the military felt the need to create a set of measures that aimed to encourage private businesses to continue borrowing from abroad.

In order to encourage the private sector’s loans with the international credit market, and also aiming to prevent deficits in the balance of payments, the Brazilian Central Bank created two new measures in legislation: Circular 230 and Resolution 432. Circular 230 was created in 1974. According to the circular, the banks authorized to function in foreign exchange – which were the banks operating through Resolution 63 – would be able to make deposits of any value at *Banco Central do Brasil* in the foreign currency correspondent to the resources from abroad that would not be employed in transfer operations⁹³. By the depositor’s request the Central Bank could return these deposits in two circumstances, if the depositor needed to pay debt amortizations and for transfers in the country⁹⁴. This measure entitled the *Banco Central* to take charge of the interest rates that would be directly remitted from the banks to the foreign creditor⁹⁵.

In addition, the currency devaluations implemented by the Brazilian economic team to slow down inflation increased the costs of borrowing. Therefore, in order to protect the private

⁹² Campos, “A Arte da Conquista”, 98.

⁹³ “Circular 230”, Banco Central do Brasil, accessed April 11, 2013.
http://www.bcb.gov.br/pre/normativos/circ/1974/pdf/circ_0230_v9_1.pdf

⁹⁴ “Circular 230”

⁹⁵ Pereira, *Financiamento externo e crescimento econômico*, 39.

sector's loans in foreign exchange, the Central Bank issued Resolution 432 in 1977, which allowed borrowers of foreign loans to deposit foreign currency in the banks that were authorized to function in foreign exchange⁹⁶. These banks were authorized to deposit these loans in the *Banco Central*, and the deposits would be protected from current devaluation of the *cruzeiros*, for the Brazilian Central Bank would accept the responsibility for the exchange risk and the costs of the debt that would be paid to the foreign creditor⁹⁷. Resolution 432 would, in theory, encourage the private sector to continue borrowing, for devaluations in the national currency would not lead to the increase of their debt, and the Central Bank would become responsible for the costs of the debt. The hope of the government was that both measures would allow certain stability to the contraction of new loans⁹⁸.

The problem, however, was that, contrary to what the authorities imagined, instead of using these regulations to continue borrowing with the international banks, these private firms were not motivated to continue contracting private loans and took advantage of these measures in order to speed up even more the process of debt relief. The private firms, and especially multinationals, which held most of the debt, started to deposit foreign exchange in the Central Bank, transferring the responsibility of the debt services to the Bank. By allowing this, the Brazilian Central Bank agreed to take over the firms' liabilities in the form of foreign currency because it became responsible for all the costs involved in the debt contraction. The government understood this as an incentive for indebtedness, and the companies saw it as an opportunity to pay off their debt. The private sector not only reduced their debt by making the Central Bank

⁹⁶ "Resolução 432", Banco Central do Brasil, accessed April 11, 2013.
http://www.bcb.gov.br/pre/normativos/res/1977/pdf/res_0432_v1_O.pdf

⁹⁷ Cruz, *Dívida externa e política econômica*, 73.

⁹⁸ Campos, "A Arte da Conquista", 98.

responsible for the debt services, but also shortened their borrowing⁹⁹. This was the first aspect of the process entitled the “nationalization of the debt”, through which the public sector would gradually become the major contractor of the Brazilian external debt.

The second aspect of the “nationalization of the Brazilian debt” can be explained by the increase of public enterprise borrowing. As explained by Cruz¹⁰⁰, the public enterprises, which had already been induced to contracting foreign resources, received a new impulse to further indebtedness with the international credit markets. The first impulse to public firms’ indebtedness during the mid-1970s would be explained by the necessity of resources to fund the II PND. The funding model chosen by the military for the Plan, according to Cruz, privileged foreign credit, and the explanation for this rested on the thesis of the “gap of resources” previously discussed. For the government, the resort to foreign credit would generate reserves that were necessary bring equilibrium to the Balance of Payments¹⁰¹. In spite of the claim that the loans would be necessary for the implementation of the II PND, Cruz claims that the ultimate goal of the external resources was to generate foreign reserves in order to bring equilibrium to the Balance of Payments¹⁰².

In addition, in 1977 the ministries were forbidden from resorting to the internal financial system to fund investment programs of subordinate organs and enterprises. The counterpart of these obstacles to internal funding was the authorities’ desire that these companies would further resort to foreign loans¹⁰³. At this moment the public companies started to, indeed, increase their loans with the international credit market. With respect to the loans registered through Law 4.131, for example, the participation of the public sector increased from 35 percent in 1974, to 60

⁹⁹ Cruz, *Dívida externa e política econômica*, 121.

¹⁰⁰ Cruz, “Endividamento Externo e Transferência de Recursos”, 125.

¹⁰¹ Cruz, “Endividamento Externo e Transferência de Recursos”, 126.

¹⁰² Cruz, “Endividamento Externo e Transferência de Recursos”, 130.

¹⁰³ Cruz, “Endividamento Externo e Transferência de Recursos”, 73.

percent in 1978. The sectors that mostly increased their participation in the debt were the power sector and the steel industry¹⁰⁴. Beyond being forbidden from resorting to internal sources of credit, the income of the public enterprises was also being threatened. The tariffs and prices of their services, which had been already suffering an intentional decline as part of a policy to combat inflation, suffered a new decrease in 1983¹⁰⁵. Therefore, besides being barred from resorting to domestic credit, the public enterprise also suffered a decline in its income.

Furthermore, Cruz argues that the public firms' indebtedness operated in a way to privilege the interests of the private sector. The most interesting example that the author gives is that since the public sector was borrowing from foreign sources, the funds mobilized by BNDE were directed under the form of subsidized credit almost exclusively to the private sector¹⁰⁶. While the public sector was borrowing from private banks from abroad, the Brazilian government was increasing the subsidies to the private sector – a policy that at during the 1970s was not necessary to safeguard the production or productivity of the private sector, and that would prove to be devastating for the country as a whole at the end of the 1970s and beginning of the 1980s when the Brazilian total debt reached the value of more than a hundred billion dollars in 1984. In addition, the author also argues that the nationalization of the debt constituted a strong instrument in which the private sector socialized the consequences of the crisis with the nation. In other words, when the state became responsible for the costs of the debt, the public in general also suffered the consequences of a debt that was held by the private sector and the particular firms that were indebted. The public funds were used in order to preserve international banking capital and specific fractions of the domestic private capital¹⁰⁷.

¹⁰⁴ Cruz, *Dívida externa e política econômica*, 116.

¹⁰⁵ Cruz, “Endividamento Externo e Transferência de Recursos”, 135.

¹⁰⁶ Cruz, “Endividamento Externo e Transferência de Recursos”, 127.

¹⁰⁷ Cruz, “Endividamento Externo e Transferência de Recursos”, 132.

Table 2 shows how during the first half of the 1970s the private sector was through law 4.131 the main borrower of loans in currency. In 1972 the percentage of the debt that was concentrated in the hands of the private sector was of 75.1 percent, while the public sector held only 24.9 percent of the borrowing under Law 4.131. At the end of the period, however, the numbers completely changed, as the private sector held only 23.2 percent of loans in currency, while the public sector became responsible for 76.8 percent of this debt.

Table 2: Loans in Currency (Law 4.131)

Structure of the annual gross inflows according to the ownership of the capital's holder (million)

	1972		1973		1974		1975	
Discrimination	\$	%	\$	%	\$	%	\$	%
Public	623.1	24.9	1130.9	39.7	1098	35.3	1900.9	50.4
Private	1874.4	75.1	1718.3	60.3	2011.5	64.7	1872.1	49.6
Total	2497.5	100	2849.2	100	3109.5	100	3773	100

Table 2 (cont.)

	1976		1977		1978		1979	
Discrimination	\$	%	\$	%	\$	%	\$	%
Public	1953.3	51.1	2500.5	51.5	5317.4	60.2	6642.9	76.8
Private	1872.7	48.9	2356.9	48.5	3511.5	39.8	2007.4	23.2
Total	3826	100	4857.4	100	8828.9	100	8650.3	100

Source: Records from the Fiscalização e Registro de Capitais Estrangeiros – FIRCE – from Banco Central do Brasil, In Cruz, 1999, page 115.

For Cruz what was just described would be the first phase of the nationalization of the debt. The second phase would begin after 1979, when the public sector increased its debt with the international banks, becoming accountable for almost 90 percent of the debt hired through Law 4.131. The intensification of the international economic crisis would come after 1979, with

the second shock of the oil prices and the drastic increase of the US interest rates. Cruz claims that after 1979 the private sector took the most advantage of the measures Circular 230 and Resolution 432, where the Brazilian Central Bank assumed the responsibility for the exchange risk and the costs of the debt. From 1979 until 1984 the *Banco Central do Brasil* would be transformed into the main borrower of foreign resources¹⁰⁸. Despite the continuance of the borrowings of the public sector from the private banks, however, the main reason for the increase of the Brazilian debt after 1979 resulted from the dramatic increase in interest rates.

3.2 Floating Interest Rates

To understand the second phase of the nationalization of the debt defined by Cruz, it is necessary to understand the conditions under which the Brazilian indebtedness with private foreign banks was held and what were the consequences of holding loans through these conditions after the deepening of the international economic crisis. From 1973 all the international private bank borrowing started being offered at floating interest rates, and from this date the adoption of floating rates was widespread. As Monica Baer argues, this increased the risk taken by the borrower, for any rise of the international interest rates could lead to a situation of financial instability. By the end of the 1970s and beginning of the 1980s, about 75 percent of the long- and mid-term Brazilian external debt was held at floating interest rates¹⁰⁹. The consequences of this debt held at floating interest rates was that the international interest rates did increase drastically, and provoked an even higher increase of the Brazilian debt.

In 1979, Paul Volcker, president of the US Federal Reserve System, in an attempt to fight inflation in the US, increased the US interest rates to levels never seen before in the country. The

¹⁰⁸ Cruz, “Endividamento Externo e Transferência de Recursos”, 128.

¹⁰⁹ Monica Baer, *O Rumo perdido: a crise fiscal e financeira do Estado Brasileiro* (Rio de Janeiro: Paz e Terra, 1993), 75.

IMF and its members had suggested that the US kept the dollar undervalued, and a new international monetary standard would emerge. However, the US would not allow it to happen. The dollar had been devaluing since 1971, and in a desperate measure to fight inflation and appreciate their currency, the US government decided to increase violently the interest rates. This policy did not only harm the peripheral nations, but the US itself, leading the country to economic recession¹¹⁰. However, it also caught the attention of the banks that were previously turned to the peripheral markets. As explained by Tavares, the increase of the interest rates by the US and the international financial instability caused the bank system to “panic” and seek refuge in the large financial markets¹¹¹.

The US policy helped to trigger a severe world recession, which not only provoked the increase of the Brazilian external debt, but that also prompted a reduction of the demand for Brazilian exports, which caused a decrease in the export earnings. In addition, there was a fall in the terms of trade in Brazil, “which declined by 46 percent between 1977 and 1982”¹¹². On one hand, there was an increase in the import prices in 1979, especially as a consequence of the shock in the oil prices – a product that fulfilled an extremely important position in the Brazilian imports list. And on the other hand, there was a decline in the export prices¹¹³.

In addition, the increase in the US interest rates influenced the dramatic increase of all international interest rates. Regarding the funds from the Euromarkets, US monetary policy of 1979 caused an “upward spiral” of the Eurodollar interest rates that went from 8.7 percent in

¹¹⁰ Maria da Conceição Tavares, “A Retomada da hegemonia americana” In *Poder e dinheiro – uma economia política da globalização*, ed. José Luiz Fiori, and Maria da Conceição Tavares (Rio de Janeiro: Vozes, 1998), 33

¹¹¹ Tavares, “A Retomada da hegemonia americana”, 34.

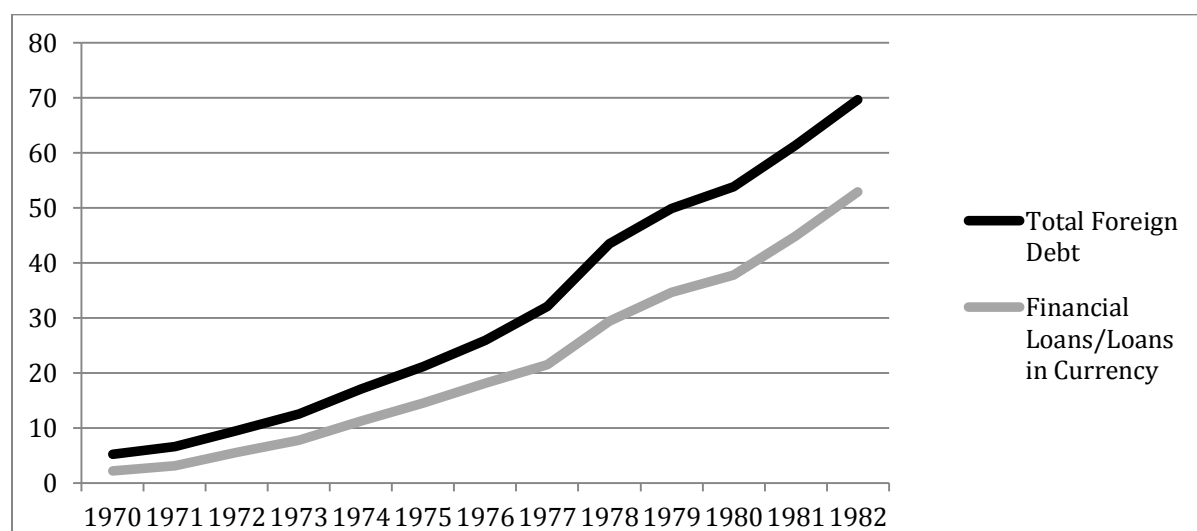
¹¹² Skidmore, *Politics of Military Rule*, 236.

¹¹³ Baer, *O Rumo perdido*, 73.

1978 to 17 percent in 1981¹¹⁴. As a consequence, the Brazilian total debt and its service payments also increased, and the system of debt roll over that was being used got threatened. The banks would not continue to lend to an economy that risked to default, and that was not growing economically, for as it was already discussed here, the foreign banks looked for opportunities to enhance their profit rates at markets in potential growth. The international credit system was virtually “closed” for the indebted peripheral nations in September 1982¹¹⁵.

The diagram 2 below shows the proportions in which the debt grew throughout the 1970s and beginning of the 1980s. In addition, the comparison between the Brazilian total debt with the portion of the debt that was only loans in currency, which represents the firms that contracted private international credit through Law 4.131, Resolution 63, and Instruction 289, shows that the total foreign debt grew at almost the exact same proportion in which the loans with the private international banks increased. This shows the direct relationship between the increase of the total debt and borrowing from private international sources.

Diagram 2: Brazilian External Debt (total vs. loans in currency)



Source: *Boletim do Banco Central do Brasil*, Maio 1983, v.19, n. 5, Brasília

¹¹⁴ Skidmore, *Politics of Military Rule*, 236.

¹¹⁵ Baer, *O Rumo perdido*, 85.

3.3 The Adjustment Policies with the IMF

According to Skidmore, the collapse of the economic policies that were being implemented to prevent Brazil from drowning into recession was confirmed in 1982¹¹⁶. In the midst of this crisis, however, what worried the developed world was the risk of the indebted countries to default. Therefore, the debt had to be renegotiated in order to enable the indebted to gradually pay it, and the role of negotiation agent was given to the IMF, which treated the creditors as the ones that needed to be helped in order to receive the services of the debt. For a few months Brazilian authorities resisted surrendering to the IMF policies. However, that intention did not endure for too long.

The Figueiredo government signed a “letter of intent” with the IMF in February 1983 and the agreement with the international private banks was concluded shortly after¹¹⁷. The IMF letter committed Brazil to meet specific targets in fiscal and monetary policy, and in foreign exchange policy and tariff policy. To receive IMF loans, Brazil would have to reach “the agreed targets on the agreed schedule or convince the IMF to grant a waiver”¹¹⁸. The “adjustment” that Brazil would go through under the tutelage of the IMF involved obtaining surpluses on the trade balance, and promoting the tightening of its monetary, fiscal and wage policies.

One of the aspects of the renegotiation of the debt, which would be intermediated by the IMF, was related to the relationship between the creditors and the indebted. Monica Baer claims that the creditors pursued two goals: to maintain ties with the indebted in order not to lose all the assets that they had invested, and to guarantee that the debtors paid as much as possible of the debt service. In order to achieve these goals, the creditors maintained a relationship with the debtors that became known as the short leash policy; the creditors would continue to provide

¹¹⁶ Skidmore, *Politics of Military Rule*, 236.

¹¹⁷ Baer, *O Rumo perdido*, 86.

¹¹⁸ Skidmore, *Politics of Military Rule*, 237.

loans to the debtors, but only to maintain their ties¹¹⁹. These resources were not supposed to – and did not – fulfill the purpose of the previous loans. They were supposed to be scarce in order to prevent the debtors from enlarging their bargaining power and to force them to subject their economies to an economic adjustment program, which would enable them to pay the debt in a near future.

Furthermore, the strategy of the creditors was to deal with each indebted country separately and individually in order to maintain the interests of the debtors as much distinctly as possible. Finally, the last characteristic of this relationship was the discourse of the hope of a way back to the market, in which the creditors tried to convince the debtors that if they adopted all the policies that were suggested by the IMF they would win their way back to access to voluntary credit¹²⁰. However, the conditions under which foreign creditors would find the peripheral countries attractive did not depend on the adjustment policies. It depended, as this work discussed previously, on foreign capital seeking profitable opportunities in growing markets. And, at this moment, the financial markets that were most rewarding were the US.

Another aspect of the renegotiation of the debt was the nature of the relationship between the creditors, who feared that debtors might form a group and gain bargaining power to renegotiate the debt, but they themselves formed a group in order to protect their interests. The group of the creditors presented themselves to the debtors as one block through the organization of bank committees. This annulled the divergences that existed between the larger and smaller banks, for the first ones were able to impose their policies of dealing with the renegotiation of the debt to the second. Furthermore, clauses that guaranteed the equal treatment of the creditors in the process of the renegotiation were created. On one hand, they forced all the banks to stay in

¹¹⁹ Baer, *O Rumo perdido*, 60.

¹²⁰ Baer, *O Rumo perdido*, 62.

the process even if they wanted to give up on the renegotiation, and on the other hand, all the clauses stated that the creditors should all be given the same benefits and should not be treated differently by the debtors¹²¹.

As already stated here, the International Monetary Fund became the agency responsible for managing the international debt crisis. This institution supervised the adjustment programs of each one of the indebted countries, and it supported the general interests of the private creditors, intermediating the renegotiation between the creditors and the debtors. One of the conditions required by the creditors was that the indebted start to implement the IMF adjustment policies in their nations before receiving new funds. If the IMF approved the implementation and results of the policies, the banks would continue to provide funds¹²².

In 1983 Brazil was able to reach a surplus in the trade balance worth of \$ 6.5 billion, something that was possible because of an expansion of 8.5 percent in exports, but mainly due to a drop of 20 percent in the value of the imports. In spite of these significant numbers in the trade balance, the “recessive adjustment” brought from the IMF only made Brazil drown even more in recession. The Brazilian GDP dropped by 3.4 percent and did not improve inflation, which reached the annual rate of 211 percent. In addition, the foreign debt continued to increase dramatically, reaching \$ 93.6 billion in 1983¹²³.

In 1984 the trade balance improved due to the recovery of international trade, which had a positive impact on exports. In addition, the fall in imports enabled a \$ 13 billion surplus in the trade balance. The current account showed a positive balance of \$ 517 million. Internally, the expansion of exports, which was led by manufactured goods, allowed the processing industry to grow, which stimulated domestic demand. These results ended up preventing the complete

¹²¹ Baer, *O Rumo perdido*, 62.

¹²² Baer, *O Rumo perdido*, 64.

¹²³ Baer, *O Rumo perdido*, 87.

fulfillment of the adjustment program because the stimulation of demand put pressure on salaries to rise¹²⁴.

In spite of the slight improvement of the economy during 1984, Brazil continued in a deep crisis during the 1980s due especially to the credit tightness that endured throughout the decade. The public sector's savings disappeared by 1985¹²⁵, and in order to fulfill the requirements imposed by the IMF, the Brazilian government had to subject its economy to spending cuts and successive policies of currency devaluation. While the public was trying to make the economy recover from a deep crisis, the private – and mostly the transnational portion of the private sector – was already freed from the consequences of deep indebtedness.

¹²⁴ Baer, *O Rumo perdido*, 89.

¹²⁵ Cruz, “Endividamento Externo e Transferência de Recursos”, 133.

CONCLUSIONS

After one decade of high rates of economic growth led by the aim to diversify the Brazilian economy through investments in industry, Brazil entered the 1980s drawn in an economic crisis that was overcome only in the present century. During the 1980s and 1990s the country not only had to solve the problem of the debt crisis, but also the extraordinary inflation that reached the rates of 1,973 percent in 1989 and 2,477 percent in 1993.

The great liquidity of resources available through the international markets in the 1960s gave the military the hope for easy economic growth and the way out of underdevelopment. Even though there are economists today who claim the funds from the Eurocurrency markets were not being converted into investments in the productive sector in Brazil, but being used to buy government bonds and speculate about their appreciation, the military government team, and specially Delfim Neto, advocated for obtaining foreign loans because they argued they were the alternative to the absence of significant internal savings. These funds would allow the modernization of the Brazilian economy and the development of the industry.

Between 1968 and 1973 the country's economy grew at extraordinary rates and put Brazil in the position of one of the largest worldwide economies during this period. However, the international economic instability from the following years determined the decline of the borrowing from the private sector and the consequent fall in their investments, and proved that the opening of the Brazilian internal market to the Euromarkets stimulated the development of a model of economic growth that proved to be unsustainable. The period of abundance of inflows of capital to Brazil gave the country a great advantage. Because the nation was a target of the movement of capitals at the end of the 1960s, or, in other words, because the funds from the

Euromarket were expecting high returns on their investments in the Brazilian internal market, the nation could use this for their advantage. The interest of the foreign capital in the Brazilian economy suggests that even if the government had not created laws that allowed better opportunities for the foreign capital, this capital would have searched for ways of entering the national economy. However, instead of taking advantage of the fact that the foreign capital needed markets that would enable their appreciation and bargaining about conditions in which they would be able to operate, they just let this capital move freely and with very few conditions. Instead of relying on only the foreign resources for incrementing the internal savings, stronger regulations in the law about profit remittances, for example, could compel foreign companies to reinvest their profits in the Brazilian economy instead of sending these profits to their headquarters.

The eagerness of the military in pushing for economic growth at any costs led to the process of the “nationalization of the debt”. In the beginning of the 1970s, 60 percent of the foreign debt in Brazil was concentrated in the hands of the multinationals. When the state decided to foment the indebtedness of the private sector and this policy did not work in the way it was expecting, the state had to not only take over the liabilities of a debt that was mainly a responsibility of the private sector, but it also safeguarded the interests of a group that would stop its investments in the Brazilian market as soon as the crisis struck. The interests of a group of private investors were preserved to the detriment of the entire public sector and, consequently, the nation. When the state nationalized the debt it brought upon itself and upon the nation’s economy the weight of the debt. The Brazilian state got to the end of the 1970s holding almost 77 percent of the Brazilian foreign debt hired through Law 4.131. In other words, the Brazilian state was responsible for 77 percent of all the debt held with private international banks.

At the end of the 1970s, as the Brazilian total debt had already accumulated to almost \$50 billion, the US Federal Reserve Bank decided to increase drastically the US internal interest rates. At this moment, the Brazilian total debt that was mostly held at floating interest rates severely increased, reaching the value of almost \$ 70 billion in the end of 1982. Such a measure was devastating not only for the Brazilian economy, but for all of Latin America that had been building its economic growth with the private loans from abroad. After Mexico declared moratorium, foreign credit inflows towards Latin America stalled, for the international banks were afraid that the indebted would default. This led to the Latin American agreement with the IMF – made in order to enable the indebted countries to pay their debt – and to the end of the Brazilian development period.

The debt-led growth and the government's reliance on the funds from the Euromarkets left the Brazilian economy extremely vulnerable to external conditions. After 1979, the increase of the international interest rates led to the risk of moratorium and the government subjected the power of decision over economic policies in the country to the IMF. Now, a country that had begun its industrialization projects in the 1950s looking for a way out of underdevelopment, wanting to diversify exports and, consequently, aiming to become less dependent on the central economies, was completely subject to the decisions of private international banks and the policies that would enable Brazil to pay the debt. After this period the Brazilian policy towards its economy would change completely and face a shift towards neoliberalism.

The study of the causes and consequences of model of debt-led growth chosen for the modernization of the Brazilian economy leads us to assert that this was not a sustainable model of growth. By choosing to use private funds from abroad in order to grow quickly, the Brazilian authorities failed to protect the country from possible scenarios of international instability.

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